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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 86

BATTEN, BARTON, DURSTINE & OSBORN, INC.
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 3-14) is reported at 9 T. C. 448. The majority, concurring, and dissenting opinions of the Court of Appeals (R. 23-28) are reported at 171 F. 2d 474.

JURISDICTION

The judgment of the Court of Appeals was entered on December 23, 1948. (R. 29.) A petition for rehearing (R. 30-34) was denied January 20, 1949 (R. 35). By an order made by Mr. Justice Jackson on April 11, 1949, the time for filing a petition for a writ of certiorari was extended to and including June 18, 1949. (R. 37.) The petition for

a writ of certiorari was filed May 27, 1949. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether the taxpayer was taxable, under the provisions of Section 19.22(a)-16 of Treasury Regulations 103, upon the gain from sales of its "treasury stock", *i.e.*, sales of shares of its own stock which, after their original issuance, the taxpayer had reacquired and had held in its treasury until the resale thereof during the taxable years.

2. If so, then whether the taxpayer was taxable not only upon gain from the sale of treasury stock which it had reacquired by purchase, but also upon gain from the sale of treasury stock which had been donated to the taxpayer by its shareholders.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 12-13.

STATEMENT

The facts, as found by the Tax Court ¹ (R. 4-9) and as recited in the majority opinion of the court

¹ Before the Tax Court, the facts in the case were developed by a stipulation between the parties, certain exhibits and oral testimony adduced in evidence, all of which were brought to the court below as part of the record on review. Only portions of that record were printed by the parties in the appendix to their respective briefs in the court below pursuant to the rules of that court, and those portions only have been included in the record filed by the taxpayer in this Court with its petition.

below (R. 23-28), may be summarized as follows:

The taxpayer is a New York corporation, organized in 1928 with an authorized capital stock of 50,000 shares of no par value and all of one class, all of which were issued upon its organization. Simultaneously, each stockholder donated to the taxpayer's treasury 20 percent of the shares initially issued to him, 10,000 shares being thus contributed to its treasury, so as to have stock available for issuance to other employees who demonstrated ability in order to insure their loyalty to the firm. The taxpayer's business is that of an advertising agency and its staff, apart from clerical and similar employees, consists largely of skilled creative writers, artists and radio directors, upon whose work the success of the business depends. (R. 4-5.)

From time to time shares of stock were sold to employees, upon recommendation of department heads and approval by the taxpayer's executive committee. Beginning in 1939, sales were made under an arrangement whereby the purchaser gave a note for the purchase price, leaving the stock with the taxpayer as security, and the interest on and principal of the note were to be paid by the application against them of dividends on the stock and by amounts deducted from the employees' bi-monthly salary checks. The purchaser had the right at any time within seven years to cancel his purchase, except as to shares already paid for, and in the event of the termination of his employment

for any reason other than death, the taxpayer had the right to repurchase any shares then unpaid for, at the original purchase price. (R. 5-6.)

The taxpayer also purchased shares from stockholders or their estates pursuant to an agreement between the stockholders and the taxpayer, under which a stockholder or his executors are required to offer his shares for sale to the taxpayer in the event of death, resignation, or discharge, the taxpayer being required to buy the shares of a deceased or discharged stockholder and having the option of buying the shares of a resigned stockholder, on terms and at a price² to be determined as prescribed by the agreement. A stockholder could sell shares only with the consent of the taxpayer, and was required first to offer them to the taxpayer. (R. 6-7.)

All purchases and sales of stock by the taxpayer were made at book value, without negotiation as to price or any attempt on the part of the taxpayer to choose a time favorable to it therefor. All of the taxpayer's outstanding stock is owned by employees, or their trustees, and is subject to the stockholders' agreement above mentioned. Seventy-eight employees were stockholders at the end of 1939, and 110 at the end of 1941. The shares were widely distributed among the employees. The

² Pursuant to the agreement, the price was to be the book value determined from the balance sheet as of the close of the preceding month.

stock was not listed on any exchange, and there is no "over the counter" market for the stock. (R. 7.)

Treasury stock was not carried as an asset by the taxpayer on its books or balance sheet, it was not voted, and no dividends were paid on it. No changes were made in the taxpayer's capital structure by reason of the purchase and sale of treasury stock. During the years 1928 to 1941, inclusive, the taxpayer acquired 55,957 shares of its stock which thereby became treasury stock, and sold 35,383 shares thereof (both figures including the 10,000 donated shares). (R. 7.)

During 1939, the taxpayer sold to officers and employees, at an average price of \$55.93 per share, 11,591 shares of treasury stock, of which 5,583 were part of the donated shares. The large sales in 1939 were due, first, to the institution of a "stock plan", whereby additional shares were allotted and sold to employees, and, second, to the taxpayer's need of additional working capital. (R. 8.)

During 1941, the taxpayer sold, at an average price of \$66.74 per share, 7,877 shares of treasury stock, all of which had been previously purchased from shareholders at various times. (R. 8.)

In his determination of deficiencies for the two taxable years, the Commissioner included in the taxpayer's income for 1939 and 1941, respectively, the amounts³ of the taxpayer's gain on the sale of treasury stock in those years. (R. 8-9.)

³ As pointed out in the opinion of the Tax Court (R. 10), there was no question as to the correctness of the *amounts*

The Tax Court upheld the taxpayer's first or main contention, to the effect that it was not taxable with any gain from the sales of treasury stock, and hence found it unnecessary to pass upon the taxpayer's alternative contention to the effect that, if taxable upon gains from the sale of treasury stock, it was taxable only upon the gain from shares reacquired by purchase and not upon gain from the sale of treasury stock which had been donated to it. (R. 9-14.)

The court below reversed, holding that the taxpayer was taxable upon the gain from its sales of treasury stock, including the gain upon the sale of donated shares. (R. 23-28.)

ARGUMENT

1. Upon the undisputed facts of this case, the court below correctly held that the taxpayer was taxable upon its gain from sales of "treasury stock" under the applicable provisions of the statute and Regulations, Section 22(a) of the Internal Revenue Code, and Section 19.22(a)-16 of Treasury Regulations 103, Appendix, *infra*.

Neither the Code nor the preceding Revenue Acts have specifically provided for the treatment

of gain determined by the Commissioner for the two years, if such gain is properly taxable. In computing the gain from the sale of the donated shares, the Commissioner allowed the taxpayer a "cost" basis, which was arrived at by taking the cost to the "donors", as finally adjusted by agreement of record during the hearing before the Tax Court. See R. 27; see also taxpayer's brief, p. 16.

for income tax purposes of the gain or loss resulting from the sale of "treasury stock" by a corporation—i.e., from the sale by a corporation of shares of its own stock which, after original issuance, it has reacquired and held in its treasury, without cancelling or retiring them. The Regulations, however, provide that the acquisition or disposition of its own stock by a corporation results in taxable gain or deductible loss depending "upon the real nature of the transaction", and that no gain or loss is to be recognized upon the original issuance of stock by a corporation but that gain or loss is recognized "if a corporation deals in its own shares as it might in the shares of another corporation". Section 19.22(a)-16, Treasury Regulations 103, Appendix, *infra*. The decision of the court below in this case is in keeping with all other court decisions which have considered the taxability of gain from sales of treasury stock under this provision of the Regulations, sustaining the taxing of such gain under a wide variety of circumstances. *Commissioner v. Rollins Burdick Hunter Co.* (C.A. 7th), decided May 19, 1949 (1949 P-H, ¶ 72,465); * *Commissioner v. Air Reduction Co.*, 130 F. 2d 145 (C.A. 2d), certiorari denied, 317 U. S. 681; *Aviation Capital v. Pedrick*, 148 F. 2d 165 (C.A. 2d), certiorari denied, 326 U. S. 723; *Helvering v. Edison Bros. Stores*, 133 F. 2d

* This is a reversal of the Tax Court's decision in *Rollins Burdick Hunter Co. v. Commissioner*, 9 T. C. 169, relied upon by the Tax Court in its opinion in this case. (R. 12-13, 14.)

575 (C.A. 8th), certiorari denied, 319 U. S. 752; *Brown Shoe Co. v. Commissioner*, 133 F. 2d 582 (C.A. 8th); *United States v. Stern Bros. & Co.*, 136 F. 2d 488 (C.A. 8th); *Allen v. National Manufacture & Stores Corp.*, 125 F. 2d 239 (C.A. 5th), certiorari denied, 316 U. S. 679; *Dow Chemical Co. v. Kavanagh*, 139 F. 2d 42 (C.A. 6th); *Edwin L. Wiegand Co. v. United States*, 60 F. Supp. 464 (Ct. Cls.). See also *Investment Corp. v. United States*, 43 F. Supp. 464 (E.D. Pa.); *Trinity Corp. v. Commissioner*, 44 B.T.A. 1219, affirmed, 127 F. 2d 604 (C.A. 5th), certiorari denied, 317 U. S. 651.

The court below properly recognized (R. 26) that the absence of a profit motive and the presence of contract restrictions and obligations did not make the gains from sales of treasury stock non-taxable. See *Commissioner v. Rollins Burdick Hunter Co.*, *supra*; *Allen v. National Manufacture & Stores Corp.*, *supra*; *Dow Chemical Co. v. Kavanagh*, *supra*; *Aviation Capital v. Pedrick*, *supra*. Nor is such result required by the fact that the particular purposes motivating the taxpayer in these transactions in its own stock could not be accomplished by dealing in the stock of another corporation. *Commissioner v. Rollins Hunter Burdick Co.*, *supra*; *Helvering v. Edison Bros. Stores*, *supra*. Equally irrelevant is the consideration that if the reacquired shares had been cancelled and retired and new shares had been subsequently issued, the tax liability might have been avoided, as the Tax Court indicated. (R. 11-12.) Tax liabilities

must be determined by what was actually done, not by what might have been done. See *Aviation Capital v. Pedrick*, *supra*, at p. 167; *Dow Chemical Co. v. Kavanagh*, *supra*, at p. 46. Contrary to the taxpayer's claim that its transactions in its own stock were merely capital readjustments (Br. 16, 18), there was no change in the taxpayer's capital structure by reason of its dealings in its own stock. (R. 7.) The transactions resulted merely in a change in the identity of the taxpayer's shareholders. See *Commissioner v. Rollins Burdick Hunter Co.*, *supra*. And, contrary to the taxpayer's claim that it was not "one cent richer" (Br. 18) as the result of its transactions, it is clear that when a corporation reacquires some of its previously issued stock, retains it in its treasury, without retiring or cancelling it, and later resells it at a profit, without any change in its capital structure, it has derived gain or profit which is real and actual and which should be taken into account for tax purposes. To permit that profit to escape taxation would frustrate the well recognized purpose of Section 22(a) of the Code to tax income or profit from whatever source derived. The decision below is clearly correct and in keeping with decisions of other courts on this question, which this Court has repeatedly declined to review. Despite the presence of an occasional dissent in the cases cited above, there is no conflict among the Circuits. Problems arising with respect to so-called "open-end" investment management companies, upon

which the petitioner predicates its assertions as to the general importance of the present case (Pet. 6-7, Br. 19-20), obviously are not parallel to those here presented and would not be resolved by a review of this case.

2. The question presented to the court below was a pure question of law as to the proper interpretation or meaning of a provision of the Regulations, in the light of undisputed facts, which the court below correctly regarded as a reviewable question. See *Commissioner v. Rollins Burdick Hunter Co.*, *supra*; *Dobson v. Commissioner*, 320 U. S. 489; *John Kelley Co. v. Commissioner*, 326 U. S. 521; *Trust of Bingham v. Commissioner*, 325 U. S. 365; *Crane v. Commissioner*, 331 U. S. 1; *McWilliams v. Commissioner*, 331 U. S. 694. Examination of the record and the decision below makes it plain that the Court of Appeals did not, as the petitioner claims (Pet. 5, Br. 14), reverse any finding of fact.

3. Having held, on the main question, that the taxpayer was taxable upon its gains from sales of treasury stock, the court below correctly also held that the gains taxable to the taxpayer included the gains from the sale of the shares which had been "donated" to the taxpayer. (R. 26-28.) There is clearly no reason for any different treatment of the "donated" shares. The taxpayer's gain from the sale of those shares was just as real as that from the sale of "repurchased" shares, and that gain should likewise be taxable just as the gain from the "repurchased" shares. No different result is

required for tax purposes by reason of any difference as to the manner in which shares have been reacquired, a matter which is immaterial, as long as their basis and the amount of the gain have been correctly computed, as they admittedly were in this case.

CONCLUSION

The decision below is correct. There is no conflict of decisions and the case presents no matter calling for review by this Court. The petition should therefore be denied.

Respectfully submitted,

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July, 1949.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) [As amended by Section 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U.S.C. 1946 ed., Sec. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.22(a)-16. *Acquisition or disposition by a corporation of its own capital stock.* Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription

or issue price be in excess of, or less than, the par or stated value of such stock.

But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code.